RECORD AND BRIEFS.

FILED
NOV 2 1 2016
OFFICE OF THE CLER

No. 15-1391

In the Supreme Court of the United States

EXPRESSIONS HAIR DESIGN, *et al.*,
Petitioners,

v.

ERIC T. SCHNEIDERMAN, IN HIS OFFICIAL CAPACITY AS ATTORNEY GENERAL OF THE STATE OF NEW YORK, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR ALAN S. FRANKEL AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

K. Craig Wildfang
Counsel of Record
Thomas J. Undlin
Ryan W. Marth
Geoffrey H. Kozen
ROBINS KAPLAN LLP
800 LaSalle Avenue, Suite 2800
Minneapolis, MN 55402
(612) 349-8500
KCWildfang@RobinsKaplan.com

Counsel for Amicus Curiae

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

IDENTITY AND INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 3

ARGUMENT 5

I. Merchants' ability to implement differential pricing for credit card transactions benefits the public. 5

II. The Australian experience confirms the benefits to the public from merchants' ability to differentially price credit card transactions. 8

III. It is less costly and more effective for merchants to communicate differential pricing as a credit card "surcharge" than as a cash "discount." 11

IV. Where permitted, merchants display a strong preference for credit card surcharges over cash discounts. 12

CONCLUSION 13

TABLE OF AUTHORITIES

CASES

American Express Anti-Steering Rules Antitrust Litigation,
11-md-2221 (E.D.N.Y.) 2

Marchbanks Truck Service, Inc. et al. v. Comdata Network, et al.,
07-cv-1078 (E.D. Pa.) 2

The Marcus Corporation v. American Express Company, et al.,
13-cv-7355 (E.D.N.Y.) 2

In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation,
05-md-1720 (E.D.N.Y.) 2

OTHER AUTHORITIES

Dennis W. Carlton and Alan S. Frankel, *Transaction Costs, Externalities, and "Two Sided" Payment Markets*, 2005 Colum. Bus. L. Rev. 617 (2005) 4

Alan S. Frankel, *Monopoly and Competition in the Supply and Exchange of Money*, 66 Antitrust L. J. 313 (1998) 4, 6, 7

Alan S. Frankel and Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627 (2006) 7

Allen Consulting Group, *Review of Reform of Australia's Payments System: Regulation of Credit Card Payments and the role of Diners Club: Report to Diners Club* (Sept. 6, 2007), *available at* http://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/past-regulatory-reviews/review-of-card-payment-systems-reforms/pdf/dc-06092007.pdf 10

American Express Australia Limited, *Review of Payments System Reforms: A Submission to the Reserve Bank of Australia* (Aug. 2007) 10

Sienna Kossman, *Survey: Card Acceptance for Tuition Rises, But So Do Fees*, CreditCards.com, August 23, 2016, available at http://www.creditcards.com/credit-card-news/colleges-charge-card-fee-survey.php 13

MasterCard Worldwide, *Payments System Regulation: Response by MasterCard Worldwide to the Issues for the 2007/08 Review* (Aug. 31, 2007), *available at* http://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/past-regulatory-reviews/review-of-card-payment-systems-reforms/pdf/mc-31082007.pdf 9, 10

Robert Mundell, *Uses and Abuses of Gresham's Law in the History of Money*, Zagreb J. Econ., Aug. 1998, *available at* http://www.columbia.edu/~ram15/grash.html 5

Schuh, et al., Federal Reserve Bank of Boston, *Who Gains and Who Loses from Credit Card Payments?* (2010), *available at* www.bostonfed.org/-/media/Documents/Workingpapers/PDF/ppdp1003.pdf 7

Reserve Bank of Australia, *Payments System Board Annual Report* (2012), *available at* http://www.rba.gov.au/publications/annual-reports/psb/2012/pdf/2012-psb-ann-report.pdf .. 8

Reserve Bank of Australia, *Payments System Board Annual Report* (2014), *available at* http://www.rba.gov.au/publications/annual-reports/psb/2014/pdf/2014-psb-ann-report.pdf 8, 11, 13

Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia I: A Consultation Document* (Dec. 2001), *available at* http://www.rba.gov.au/payments-and-infrastructure/credit-cards/ia-consult-doc/pdf/ia-consult-doc.pdf 13

Reserve Bank of Australia, *Review of Card Payment Regulation, Conclusions Paper* (May 2016), *available at* http://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/review-of-card-payments-regulation-conclusions-paper-2016-05.pdf 9

Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behav. & Org. 39 (1980) 11

Stuart E. Weiner and Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, 4 Rev. Network Econ. 290 (2005) 6

IDENTITY AND INTEREST OF *AMICUS CURIAE*

The *amicus* has been a professional economist since 1985. He is President of Coherent Economics, LLC, a Senior Editor of the Antitrust Law Journal, a member of the U.S. Advisory Board of the Loyola University Chicago Institute for Consumer Antitrust Studies, and an Adjunct Professor at the Loyola University Chicago School of Law.[1] He received a Ph.D. in economics from the University of Chicago in 1986.

The *amicus* has undertaken extensive research into the nature of competition in payment systems and has been deeply involved in legal, regulatory, and policy disputes arising in credit card markets for over 25 years. He has published numerous articles concerning competition in payment card networks, including articles that investigated in detail the history and competitive effects of prohibitions on merchant surcharging or discounting.

---

[1] *Amicus* certifies that no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money intended to fund the preparation or submission of the brief; and no person other than *amicus* or his counsel contributed money intended to fund the preparation or submission of the brief. *See* Sup. Ct. R. 37.6. *Amicus* advised counsel to all parties of his intent to file this brief on November 8, 2016, and counsel for Petitioners gave consent to the filing at that time. Counsel for Respondent Eric T. Schneiderman and Respondents Cyrus R. Vance and Kenneth P. Thompson each consented to the filing on November 10, 2016.

The *amicus* has served as an expert economist in engagements involving payment card networks—often involving disputes concerning contractual or legal restrictions on merchant surcharging or discounting—in the United States as well as Australia, Canada, Chile, the European Union, New Zealand, and the United Kingdom. In Canada, Chile, New Zealand, and the United Kingdom, he was engaged to serve as an expert witness by national competition authorities. In the United States, he has served as an expert economist in many disputes relating to payment card networks.[2] He has spoken about competition in payment card systems around the world, including at events sponsored by the Federal Reserve Bank of New York; the Federal Reserve Bank of St. Louis; the Federal Reserve Bank of Chicago; the Federal Reserve Bank of Kansas City; the American Bar Association's Section of Antitrust Law; the American Bar Association's Consumer Financial Services Committee; the American Antitrust Institute; Harvard Law School; the Chicago Bar Association; the Econometric Society in Auckland, New Zealand; the Organization for Economic Cooperation and Development in Paris, France; the International Cards and Payments Council

---

[2] These include analyses of restraints on surcharging and discounting in the MasterCard and Visa networks in *In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, 05-md-1720 (E.D.N.Y.); in a credit card network that serves truck stops and truck fleet operators in *Marchbanks Truck Service, Inc. et al. v. Comdata Network, et al.*, 07-cv-1078 (E.D. Pa.); and in connection with a proposed settlement in *American Express Anti-Steering Rules Antitrust Litigation*, 11-md-2221 (E.D.N.Y.) and *The Marcus Corporation v. American Express Company, et al.*, 13-cv-7355 (E.D.N.Y.).

in Rome, Italy; the Canadian Bar Association in Toronto; and at a conference in Sydney, Australia sponsored by the Reserve Bank of Australia and the Melbourne Business School.

The *amicus* believes that a competitive retail economy provides substantial benefits to the public. The ability of merchants to freely determine the prices they charge in competition with other merchants and to communicate those prices to the public is fundamental to the efficient functioning of the retail economy. State laws which prohibit merchant "surcharging" of credit card transactions impede merchants' ability to convey price information, which in turn impedes the competitive process and harms the public overall. Lower income consumers, who disproportionately use cash to complete transactions, are especially disadvantaged.

SUMMARY OF ARGUMENT

Competitive markets generate tremendous benefits for the public. Central to the functioning of a competitive marketplace is the price system—the ability of merchants to establish prices for different goods or services and *communicate* those prices to customers or potential customers.

When two transaction types impose different costs on a merchant, the merchant has a choice: set a lower price for the lower-cost transactions and a higher price for the higher-cost transactions, or set one intermediate price for all transactions. The likelihood a merchant will set different prices depends on the amount by which the costs differ, the cost of implementing differential prices, and the cost and effectiveness of

communicating the multi-price system to consumers. Dennis W. Carlton and Alan S. Frankel, *Transaction Costs, Externalities, and "Two Sided" Payment Markets*, 2005 Colum. Bus. L. Rev. 617, 620 (2005). Impediments to differential pricing at the point of sale—based on differences in the cost or value of alternative forms of money—have been a cause of intense controversies in this country since the founding. Alan S. Frankel, *Monopoly and Competition in the Supply and Exchange of Money*, 66 Antitrust L. J. 313, 324-43 (1998) [hereinafter, *Monopoly and Competition*].

Because of the high fees that merchants pay to accept credit cards, many would prefer to use differential pricing on credit card transactions. This would generate substantial benefits to the public, but some of the gains would come at the expense of credit card issuers, who would face more effective competition from other payment methods.

Some states permit merchants to price differentially by offering "discounts" for cash, debit cards, or checks, while forbidding merchants from communicating mathematically equivalent price differentials as credit card surcharges. The direct economic effects of discounts and surcharges *on consumers* are identical. But the costs *to merchants* of discounting are significantly higher than those of surcharging. As a result, when state laws prohibit surcharging, fewer merchants will engage in differential pricing, depriving the public of the substantial benefits that would result.

ARGUMENT

I. Merchants' ability to implement differential pricing for credit card transactions benefits the public.

In economics, a "market failure" is a situation in which individuals acting rationally according to their incentives fail to produce the optimal outcome for society. Examples of market failures involving "externalities" would be the emission of pollution from a factory or automobiles. When a market failure occurs, the market fails to allocate resources efficiently, and society as a whole is less well-off than if the externalities could be eliminated.

One of the earliest known forms of market failure occurred when differential pricing was impractical—i.e., too costly, given the available technology—or was legally restricted. Historically, this was a problem of debased or non-standardized coinage. When the money presented for payment differed in intrinsic value, but prices did not vary accordingly, the result, as described by the popular formulation of *Gresham's Law*, was that "bad money drives out the good." The harmful effects of Gresham's Law have been recognized for centuries. Robert Mundell, *Uses and Abuses of Gresham's Law in the History of Money*, Zagreb J. Econ., Aug. 1998, at 57, *available at* http://www.columbia.edu/~ram15/grash.html. My research has extended the insights of Gresham's Law, drawing from historical disputes related to payment systems in the United States, including disputes over privately issued currency during the Nineteenth Century, the interbank check-clearing system that followed, and modern electronic credit card systems. I have shown that Gresham's Law

can be restated: "expensive forms of money tend to displace the inexpensive." *Monopoly and Competition, supra*, at 326. This occurs when merchants' prices do not adjust to take different costs into account.

Credit card networks impose substantial fees on merchants for credit card transactions, making credit cards a relatively costly payment method for merchants. This is especially true in the United States. Stuart E. Weiner and Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, 4 Rev. Network Econ. 290, 299 (2005). Many merchants—and their customers—would be much better off if the merchants were able to avoid these costs, such as by steering (incentivizing) consumers to use cheaper payment methods. Unfortunately, relatively few merchants in this country engage in such steering. The problem has proven persistent, despite reductions in the cost of administering different prices at the register and legislative efforts to facilitate differential pricing. A major reason is the continued existence of prohibitions against communicating the higher price as a "surcharge" (e.g., "credit card convenience fee"), rather than all other payments at a "discount."

When users of low-cost payment methods are offered a "discount," merchants must set the list price of goods at a higher level. This higher list price can effectively discourage merchants from offering "discount" differential pricing entirely, as described in Part III, *infra*. If merchants choose not to offer differential pricing through discounts, they are likely to adopt intermediate prices that spread the cost of credit card transactions over the entirety of their sales.

This hits lower income Americans particularly hard, because they disproportionately use cash, and so receive none of the benefits that credit card users receive (which partly offset the higher retail prices those customers pay). *Monopoly and Competition*, *supra*, at 346-47; *see also* Schuh, et al., Federal Reserve Bank of Boston, *Who Gains and Who Loses from Credit Card Payments?* 1 (2010), *available at* www.bostonfed.org/-/media/Documents/Workingpapers/PDF/ppdp1003.pdf.

When the cost of credit cards is opaque to consumers, they often opt for the convenience of credit cards. The problem is exacerbated by credit card rewards programs which disproportionately benefit wealthy consumers. Rewards programs are designed to induce consumers to use a costly credit card as their default choice, based on increased individual benefit. The result is consistent with Gresham's Law. "If the merchant does not surcharge use of the card, then the consumer's individual interest will be served by choosing a relatively costly card . . . even if the combined benefit to the cardholder and merchant would be greater if the consumer used a different form of payment." Alan S. Frankel and Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627, 645 (2006). In economic effect, the poorest Americans contribute to the funding of credit card rewards earned disproportionately by the wealthiest, while most consumers—and all consumers in the aggregate—are, on net, worse off.

II. The Australian experience confirms the benefits to the public from merchants' ability to differentially price credit card transactions.

When merchants price transactions to reflect the cost difference between cash (or debit cards, another low-cost option) and credit cards, their customers are incentivized to take into consideration not only their own costs and benefits, but also the differential costs imposed on the merchants resulting from that choice. And where merchants can communicate differential pricing as a lower base rate with an additional surcharge for credit card use, many choose to do so. In Australia, for example, where merchants have been able to surcharge credit card transactions since 2003, 43 percent of merchants included surcharges for at least some credit card transactions in 2014. Reserve Bank of Australia, *Payments System Board Annual Report* 33 (2014) [hereinafter, *PSB 2014 Report*], *available at* http://www.rba.gov.au/publications/annual-reports/psb/2014/pdf/2014-psb-ann-report.pdf. Although larger merchants are more likely to surcharge than small merchants, a significant fraction of even very small merchants implement credit card surcharges when they are permitted to do so. Reserve Bank of Australia, *Payments System Board Annual Report* 25 (2012), *available at* http://www.rba.gov.au/publications/annual-reports/psb/2012/pdf/2012-psb-ann-report.pdf.

Economic efficiency is enhanced and retail prices decline when merchants can effectively price credit card transactions differently. The Australian central bank summarizes the benefits of merchants' ability to surcharge credit card transactions:

> The ability of merchants to levy surcharges on different types of payment instruments is an important mechanism for promoting the efficient allocation of resources in the payments system. It allows merchants to signal the costs of different payment choices and to pass on these costs to users, aligning end users' private costs more closely to social costs and thereby contributing to a more efficient payments system. The outcome is that merchants are able to set prices for goods and services lower than would be the case if surcharging was prohibited, and the extent to which users of lower cost payment methods subsidise users of higher cost methods is reduced. The ability to surcharge also potentially improves merchants' bargaining position in relation to different payment methods, which can help keep downward pressure on merchant service fees and interchange fees.

Reserve Bank of Australia, *Review of Card Payment Regulation, Conclusions Paper* 30 (May 2016), *available at* http://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/review-of-card-payments-regulation-conclusions-paper-2016-05.pdf. MasterCard acknowledges that a merchant's "decision to surcharge card sales... would be accompanied by the scope for reducing prices for non-credit card sales." MasterCard Worldwide, *Payments System Regulation: Response by MasterCard Worldwide to the Issues for the 2007/08 Review* 17 (Aug. 31, 2007) [hereinafter, *MasterCard Response*], *available at* http://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/past-

regulatory-reviews/review-of-card-payment-systems-reforms/pdf/mc-31082007.pdf.

Finally, the ability to communicate surcharges has other expected beneficial effects. Credit card networks have acknowledged that merchants' ability to effectively communicate differential pricing makes competition more effective and induces the networks to set lower merchant fees. *See MasterCard Response*, *supra*, at 16-17 (Merchants' ability to discourage card use through surcharging "should be more than sufficient to avoid excessive interchange fees."); American Express Australia Limited, *Review of Payments System Reforms: A Submission to the Reserve Bank of Australia* 9 (Aug. 2007) ("Merchant benefits from the reforms include... increased bargaining power with [credit card network members] from the ability – or the threat – to surcharge"); Allen Consulting Group, *Review of Reform of Australia's Payments System: Regulation of Credit Card Payments and the role of Diners Club: Report to Diners Club* 11 (Sept. 6, 2007), *available at* http://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/past-regulatory-reviews/review-of-card-payment-systems-reforms/pdf/dc-06092007.pdf ("competitive forces have led to falls in Diners Club [merchant fees] over time. From the time that merchants have been permitted (but not obligated) to surcharge, these falls have been particularly large."). Incentives to avoid credit card use could significantly increase the competitive constraints on merchant fees imposed by card networks, which causes the high cost of credit card transactions in the first place.

III. It is less costly and more effective for merchants to communicate differential pricing as a credit card "surcharge" than as a cash "discount."

A price of $99 with a $2 surcharge for use of a credit card and a price of $101 with a $2 discount for use of cash are economically identical—assuming the consumer makes the same decision in either case. In practice, consumers do not behave as if the two are identical. It is much more difficult—costlier and less effective—to influence a consumer decision by framing the differential price as a cash discount than it is by promoting the lower price and framing the differential as a willingness to accept credit cards with a surcharge. *See* Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behav. & Org. 39, 45 (1980).

Even if an individual consumer would make the same choice, in the aggregate there is a first-mover disadvantage to a merchant choosing to offer discounts. With surcharges, merchants can reduce their posted prices and allay concerns that they will lose customers before those customers have a chance to digest the net impact of the change. Permitting merchants to frame differential prices as "surcharges" rather than "discounts" allows merchants to accurately pass on credit card fees with less concern that they will lose customers who avoid a merchant based on the higher list price—as would occur with "discounts."

Where it is permitted, many merchants choose to use differential pricing for only one or two of the most expensive credit card brands. *PSB 2014 Report*, *supra*, at 33. With a surcharge, this is quite simple. For

example, an Australian merchant might disclose "American Express, 1.5% surcharge" at the point of sale. A discount-only law, however, complicates the situation for merchants and for customers. It compels such a merchant to set its retail prices at the highest, American Express level—even if the merchant has few customers who pay with American Express cards—and communicate a 1.5% discount for Visa, MasterCard, debit cards, checks, and cash.

In sum, the prohibition on structuring a differential pricing system as a surcharge significantly increases the cost to the merchant of communicating a dual-price system, and reduces the effectiveness of that communication. Most merchants are therefore deterred from differential pricing.

IV. Where permitted, merchants display a strong preference for credit card surcharges over cash discounts.

Consistent with the analysis above, experience has confirmed that where merchants have the option either to frame a differentiated price as a surcharge on credit card transactions or as a discount on all other transactions, they are far more likely to choose the former. For example, unlike other merchants, universities in the United States were permitted by credit card networks to implement credit card surcharges on tuition payments. Whereas cash (or check) discounts on tuition were uncommon or nonexistent, surcharges, styled "convenience fees," immediately gained traction. A recent survey found that the percentage of schools accepting credit cards for tuition payments has grown, and—not coincidentally—among the schools that accept cards, 57 percent now

assess a credit card surcharge. There is no indication that even a single university sets tuition based on the use of a credit card and offers a discount for check payments. Sienna Kossman, *Survey: Card Acceptance for Tuition Rises, But So Do Fees*, CreditCards.com, August 23, 2016, available at http://www.creditcards.com/credit-card-news/colleges-charge-card-fee-survey.php.

Similarly, prior to the repeal of rules forbidding surcharges in Australia, the Reserve Bank of Australia noted that discounts for cash were common only for "high-value goods" such as home appliances. Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia I: A Consultation Document* 32 (Dec. 2001), *available at* http://www.rba.gov.au/payments-and-infrastructure/credit-cards/ia-consult-doc/pdf/ia-consult-doc.pdf. As previously noted, by contrast, 43 percent of Australian merchants surcharged at least some credit card transactions in 2014. *PSB 2014 Report*, *supra*, at 33.

CONCLUSION

Price differentials that reflect differential costs of different customers or transactions are ubiquitous. When a merchant discloses that additional fees will be assessed for additional services, whether for giftwrapping, delivery, or use of a credit card, the merchant's customers can evaluate whether the optional service is sufficiently valuable to justify the added cost. Enabling merchants to set different prices for credit card transactions and effectively communicate those differentials as a credit card "surcharge" provides substantial benefits to the public. Permitting only "discounts" for non-credit card

transactions fails to impart the same benefits. Laws prohibiting surcharging increase the costs to merchants of informing consumers, reduce the effectiveness of that information, and harm the public through overall higher prices.

Respectfully submitted,

K. Craig Wildfang
Counsel of Record
Thomas J. Undlin
Ryan W. Marth
Geoffrey H. Kozen
ROBINS KAPLAN LLP
800 LaSalle Avenue, Suite 2800
Minneapolis, MN 55402
(612) 349-8500
KCWildfang@RobinsKaplan.com

Counsel for Amicus Curiae

November 21, 2016